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C O N F I D E N T I A L SECTION 01 OF 02 BEIJING 000268

SIPDIS

STATE FOR EAP/CM SFLATT
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SUBJECT: TAIWAN ARMS SALES: U.S. FIRMS' EXPOSURE TO
CHINESE SANCTIONS

REF: BEIJING 260

Classified By: Econ M/C William Weinstein. Reasons 1.4 (b) and (d).

11. (C) SUMMARY. Representatives of major U.S. firms involved in the Taiwan arms deal (and with significant China operations) tell the Embassy they are concerned about possible Chinese sanctions resulting from the deal, but have not yet been contacted by Chinese authorities. Chinese media have focused on the possible impact to the U.S. aviation industry, which recorded USD 6 billion in exports to China in 12009. However, many of these firms are deeply integrated into the Chinese economy, with localized manufacturing and supplier relationships that also pose vulnerabilities for Chinese interests if sanctions get extreme. END SUMMARY.

12. (C) Econoff spoke with leading involved U.S. firms in Beijing to assess their exposure to Chinese sanctions threatened in the MFA's January 30 press release. To date, none of the U.S. firms named by the USG as suppliers in the Taiwan arms deal have been contacted by Chinese authorities over their involvement in the arms package. Possible sanctions were the front page story in the February 2 China Daily, with a National Defense University analyst stating they have yet to be announced. Per reftel, this is the first time the Chinese government has publicly threatened sanctions on the specific firms involved, though Boeing noted that in the past it was called to meetings intended to discourage its involvement in such deals, but so far has not been in this case.

BOEING: China Sales of USD 2.5-3.5 Billion

13. (C) Boeing Corporation's China told us today that their China revenue ranges from USD 2.5 to 3.5 billion per year (slightly lower than estimated reftel). Sales are primarily commercial aircraft, with 50 aircraft delivered to Chinese airlines in 2009 -- mostly short-haul, narrow-body Boeing 737s. The company also earns limited additional revenue from services. Although Boeing earlier dominated the China market, it now shares the market roughly 50/50 with Airbus. (NOTE: A Chinese row with France in 2009 over President Sarkozy's meeting with the Dalai Lama did not have a

perceptible impact on Airbus' market share in China, in spite of much speculation to the contrary and a threatened moratorium on future contracts. END NOTE.)

14. (C) Boeing's position in the China market for long-haul aircraft is stronger, roughly 75 percent, but has been hurt by the two-year delay of the 787 Dreamliner. Boeing expects 787 deliveries to begin in late 2010, but initial deliveries will go to All Nippon Airways with China-bound deliveries not likely until 2011. Chinese officials have complained steadily about the negative impact to Chinese carriers from 787 delays. In September 2009, Boeing reached agreement with six Chinese airlines to modify 787 delivery dates, and only one cancelled its purchase plan.

15. (C) Boeing also has a range of supplier relationships with China's aviation conglomerate, AVIC, including supply of some composite materials components and tail and wing components. Chinese industrial policy specifically encouraged these supplier relationships and AVIC values them highly. Boeing has been careful to build relationships within this system, while ensuring that it diversifies supply beyond China for critical components. This business area may therefore be relatively insulated.

UNITED TECHNOLOGIES: USD 2.7 Billion in 2009

16. (C) United Technologies Corporation (UTC) is another major aviation conglomerate involved in the Taiwan arms deal through its Sikorsky Helicopter division. UTC generated USD

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2.7 billion in Chinese revenue in 2009. However, over 60 percent of that revenue is from UTC's building and infrastructure business, with under 40 percent from aviation-related businesses. Moreover, UTC reports that 90 percent of its Chinese revenue comes from products manufactured locally in China.

17. (C) Nearly all of UTC's business units are deeply involved in China, many through local production ties. Pratt and Whitney supplies aircraft engines to Chinese airlines, including some through PW Canada division. Sikorsky has supplied search and rescue helicopters to the Ministry of Transport, but lost the most recent bid to Eurocopter in mid-2009. Sikorsky also has manufacturing in China, where AVIC manufactures the company's S76 helicopter frames. Its Carrier business unit supplied heating and cooling systems to 70 percent of the Olympic venues in Beijing. Otis Elevator also delivered 1400 elevators to the Olympics project through 2008, valued at USD 100 million. UTC's Fire and Security Systems has provided systems to the Beijing subway system.

GE AVIATION

18. (C) General Electric (GE) Aviation sales in China reached USD 800 million in 2009, involving primarily aircraft engines. The division's products are largely imported, with only one small manufacturing facility for aviation components in Suzhou. The GE group, however, has sales here of approximately USD 5 billion per year, and its energy, health care and other units are heavily invested in local production throughout China.

LOCKHEED, RAYTHEON AND OTHERS

19. (C) Lockheed confirmed it had almost no business in China, and employs only one full-time representative. Lockheed had dabbled in China's air traffic management equipment market, but withdrew two years ago. The firm maintains a small joint venture with the China Meteorological Administration to produce weather radar systems. This small JV in Beijing and Xiamen has only 100 employees.

¶10. (C) Raytheon contacts were unavailable for comment, but in a visit to the Embassy in 2009 confirmed that it has a trickle of business in China from the maintenance of older air traffic control (ATC) systems. Chinese authorities have explicitly told the firm in the past that its sales to Taiwan would effectively limit the potential of its business in the mainland. Raytheon representatives tell us it comes down to a "a simple business decision," military sales to Taiwan were much greater than the potential ATC system sales in the mainland.

¶11. (C) COMMENT. At first glance, huge U.S. aviation exports to China appear vulnerable to sanctions, but the complex customer, supplier, and partner relationships mean sanctions could also affect Chinese interests if carried to an extreme.

END COMMENT.
HUNTSMAN